



## RATING ACTION COMMENTARY

# Fitch Rates \$265MM State of Washington GOs 'AA+'; Outlook Stable

Thu 21 Oct, 2021 - 10:50 AM ET

Fitch Ratings - San Francisco - 21 Oct 2021: Fitch Ratings has assigned a 'AA+' rating to the following State of Washington general obligation (GO) bonds:

--\$131,845,000 various purpose GO refunding bonds, series R-2022A; and

--\$132,770,000 motor vehicle fuel tax GO refunding bonds, series R-2022B.

The Rating Outlook is Stable.

The series R-2022A and series R-2022B bonds are expected to sell competitively on November 2. The proceeds of the bonds will be used to refinance outstanding GO bonds for savings.

## SECURITY

All GO bonds are general obligations of the state to which the state has irrevocably pledged its full faith, credit and taxing power.

## ANALYTICAL CONCLUSION

Washington's 'AA+' IDR and GO bond rating reflect the state's large and diverse economy, with solid long-term revenue growth prospects, a demonstrated commitment to fiscal balance and combined long-term liabilities that place a low burden on resources. The ratings also reflect the state's very strong financial resilience supported by reserves, a statutory requirement for a balanced multiyear budget and formulaic funding of the constitutional budget stabilization account (BSA), which has reduced reliance on above-average revenue growth.

## **Economic Resource Base**

Prior to the pandemic-induced downturn, Washington's economy was characterized by exceptional growth and increased employment diversification outside the traditionally dominant manufacturing sector, primarily information technology-related interests. Income levels are above average. The state removed all pandemic-related restrictions July 1, and is well positioned for continued expansion over time given robust population and labor force growth.

## **KEY RATING DRIVERS**

### **Revenue Framework: 'aaa'**

Revenue performance over time has generally been above inflation, and Fitch expects this to continue to support solid growth prospects. The state has complete independent control over taxation, with an essentially unlimited legal ability to raise operating revenues as needed.

### **Expenditure Framework: 'aa'**

Washington benefits from solid expenditure flexibility, although its flexibility is somewhat more restricted than is true for most states due to court mandates on education funding. The state has a low burden of carrying costs for debt service and retiree benefits and benefits from the broad expense-cutting authority common to most U.S. states. Medicaid is also a key cost driver; however, Fitch expects these costs to remain manageable.

### **Long-Term Liability Burden: 'aaa'**

The combined burden of debt plus pensions is low as a percentage of personal income but above the median for U.S. states. Elevated debt ratios incorporate the funding of substantial capital needs, particularly for transportation, but are offset by a moderate net pension liability and growth in population and personal income.

## Operating Performance: 'aa'

Washington maintains very strong gap-closing capacity in the form of its superior budget flexibility and solid reserves. The state is well positioned to deal with economic volatility given its significant control over revenues and spending, as well as robust budgetary reserves and the BSA.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Strong economic and revenue growth that outpaces GDP over time;

--Ability to maintain higher spending for education while maintaining superior financial flexibility, including through maintaining reserves around current levels.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--A material and sustained increase in the long-term liability burden to 10% or more of personal income;

--Failure to implement policy measures to counteract changing economic conditions and address budgetary challenges, which would be contrary to Washington's past practices and Fitch's expectations.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## CURRENT DEVELOPMENTS

Federal Relief Provides Support

Washington has been allocated about \$6.6 billion in federal coronavirus relief funding since March 2020 (\$2.2 billion in Coronavirus Aid, Relief and Economic Security Act of 2020 and \$4.4 billion from the American Rescue Plan Act [ARPA] of 2021). Washington's spending plan for the ARPA funds is related primarily to school reopening, rental assistance, vaccine deployment, and services for low-income individuals, as well as to address a federal injunction related to fish culverts under state highways. Overall, Washington estimates state, local and individuals received \$27 billion in federal stimulus funding in 2020 and 2021 equal to roughly 5% of the state's annual GDP.

### Economic and Revenue Recovery Continues

The state's September 2021 forecast indicated that while employment gains continue, the pace lags expectations. According to the state, employment remains 3.1% below the February 2020 employment level. Fitch's U.S. State Labor Tracker published September 2021 shows that the state's employment losses were below the U.S. states' median at 11.7% (median is 13.7%) and have recovered at about the same pace as the U.S. state median. Despite the positive recent trends, uncertainties remain, including the possibility of new waves of coronavirus infections resulting in business failures, weak demand and additional job losses.

### Washington Fiscal Update

Washington forecasts that it finished the 2019-2021 biennium (fiscal years 2020 and 2021, ended June 30) with \$3.8 billion in combined general fund balance and the BSA, equal to about 14% of total general fund -- state revenues (taxes and other non-tax state revenues [GF-S revenues]). This represents an increase over the 2017-2019 biennium ending fund balance and BSA of \$2.6 billion, equal to about 11.7% of audited fiscal 2019 GF-S revenues.

Based on the September 2021 quarterly revenue forecast, GF-S revenues will be higher than the June 2021 forecast by \$542 million absent policy actions, with most of the increase in the second year of the biennium. Retail sales and use and business and occupation taxes continue to improve over the same period in 2020 and month over month.

The September forecast puts the combined general fund reserves and BSA about \$900 million higher than the June 2021 forecast, at about \$4.5 billion at the end of the 2021-2023 biennium. The state transferred the BSA balance of \$1.8 billion to the general fund in fiscal 2021, as permitted under the state constitution, to provide budgetary flexibility. The BSA will be replenished from constitutionally required transfers of 1% of GF-S revenue (roughly \$500 million per biennium).

The enacted 2021-2023 biennial budget includes a new excise tax on gains from the sale of certain assets, generally targeted at capital gains from securities rather than real estate or businesses. While not included in the enacted biennial budget, the June 2021 revenue forecast estimates it will generate \$415 million in the biennium. The tax is being challenged as unconstitutional. Offsetting concerns about the ultimate validity of the new tax stream, the tax is not effective until January 2022 with the first payments not due until April 2023 and, as noted, the enacted budget does not include use of the projected revenues.

The tax collections will be deposited into the Education Legacy Trust Account (ELTA) a special revenue fund, which may be used only for support of K-12 public schools, certain higher education purposes, and in support of early learning programs. Funds in the ELTA are not yet appropriated. The budget also includes an \$800 million deposit into the state teacher pension system to reduce the unfunded liability.

## **CREDIT PROFILE**

The state's financial resilience rests on frequent reviews of economic and financial forecasts, allowing the state to respond effectively to changing conditions. As the economy and revenues repeatedly and significantly underperformed estimates in the Great Recession, the state demonstrated its willingness and ability to utilize broad budget flexibility in response. The state implemented a combination of ongoing and one-time actions and fully depleted accumulated reserves. Fitch expects the state to similarly make use of its very strong gap-closing capacity, supported by its solid, reinstated reserve position, during future cyclical downturns.

For additional information, see "Fitch Rates \$850MM State of Washington GO Bonds 'AA+'; Outlook Stable," dated July 15, 2021.

## **DATE OF RELEVANT COMMITTEE**

14 July 2021

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Washington, State of (WA) [General Government]				
● Washington, State of (WA) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 ([1](#))

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